Reforming the land market

How land reform can help deliver the government target of 300,000 new homes per year

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centre for progressive policy

Thomas Aubrey

Centre for Progressive Policy

About the Centre for Progressive Policy[1]

The Centre for Progressive Policy is a new think tank committed to making inclusive economic growth a reality. By working with national and local partners, our aim is to devise effective, pragmatic policy solutions to drive productivity and shared prosperity in the UK.

Inclusive growth is one of the most urgent questions facing advanced economies where stagnant real wages are squeezing living standards and wealth is increasingly concentrated. The Centre believes that a new approach to growth is needed, harnessing the best of central and local government to shape the national economic environment and build on the assets and opportunities of place.

Centre for Progressive Policy
27 Great Peter Street
London SW1P 3LN

+44 (0)20 7070 3360
www.progressive-policy.net

1 In March 2018, the Centre for Progressive Capitalism was incorporated into the Centre for Progressive Policy. All prior Centre for Progressive Capitalism research can be found at: http://progressive-policy.net/

A new analysis from the Centre for Progressive Policy shows that the government can reach its target of 300,000 additional homes by reforming the land market. The research estimates that reforms to the land market, which would bring down the cost of land, could deliver:

- An additional 96,500 homes a year
- Of which 36% (35,000) would be affordable
- This would bring the number of new homes built in the UK up from around 184,000 to 280,000

Challenges: can we build more homes with a broken system?

The government have recently upped their housebuilding target to 300,000 net additional homes per year for England. This will require new build completions specifically to rise from around 184,000 to somewhere close to 280,000 new units a year.

Given this number has not been reached since the 1970s, there are a number of hurdles to overcome in order to meet it. Primarily, this requires a sufficient increase in the supply of land at reasonable cost across the private, housing association and local authority sectors. The current challenges in meeting this new target include:

- Requirement to bid for land parcels makes it **prohibitively** expensive for smaller scale builders & housing associations as well as cash-strapped local authorities to acquire land. It also prevents volume housebuilders from expanding at faster rates if they are to maintain their profitability levels. This business model has led to consolidation in the sector with a dramatic reduction in the number of housebuilders.
- Too many planning permissions are held by non-house builders due to their ability to profit from rising land values.
- Lower levels of infrastructure investment have meant that fewer large scale sites are opened up and the ability to claw back only a quarter of the uplift in land values means there are insufficient funds to fund new infrastructure.

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The way in which the land market works is largely a function of the compensation rules set out by Parliament, which define the levels at which land will trade at. When the compensation rules assume that land will be awarded planning permission in the future, then land will trade at levels close to residential value. If the rules do not award compensation for prospective planning permission as in Germany, then market values will trade at levels close to either agricultural or industrial land.

The land market in the UK operates differently to many countries in Continental Europe and Asia as the land compensation rules require that landowners be compensated at values including the assumption of planning permission in the event that land is acquired by the state for new housing rather than the value of the land related to its current use. This means the legal rules that govern the land market require the returns from monopoly pricing to flow through to landowners.

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In countries with significantly higher housebuilding rates, most of the value of rising land flows to the community rather than landowners. This is because their legal systems recognise that rising land values are derived from demand created by local firms and workers, and the public authority awarding planning permission. This reduces the speculative nature of the land market thereby creating a far more efficient system as seen in countries such as France, The Netherlands and Germany.

Table 1: Housebuilding rates: European Comparison 1975 – 2013

	Average dwellimgs constructed per 1000 population 1975-2013
TheNetherlands	6.0
France	5.5
Germany	4.7
Denmark	4.4
Sweden	4.0
UK	3.6

Source: Centre for Progressive Capitalism / National statistical sources[2]

Instead the land compensation rules across the UK award the uplift to landowners which has led to the speculative model of development that has come to dominate housebuilding. This system creates huge incentives for investors to own land as an asset rather than build on it, which is why so many planning permissions are owned by non-building firms and are therefore not built out. This is why the government must look at changing the rules of the land market if it wishes to increase housebuilding,

2 Aubrey, T. (2015) Britain's dysfunctional housing market: a European comparison. Available at: http://www.policy-network.net/pno_detail.aspx?ID=4985&title=Britain%E2%80%99s+dysfunctional+housing+market%3a+a+European+comparison#_ftn1

rather than merely criticising housebuilders who are forced to operate within the system affected by these incentives.

These rules have also restricted the use of rising land values to help fund local infrastructure projects as the high price of land often makes large scale projects that require significant investment unviable. When such projects are viable, a great deal of the investment is in effect unproductive as it purely needs to pay for the high price of land, limiting the boost to the economy. This is why spending more public money and raising general government debt by itself would not be an efficient way of funding large scale urban developments.

Solutions: reforming the 1961 Land Compensation Act

One approach to reforming the land market is to amend the land compensation rules to reduce the incentives to hoard and speculate on land[3]. This can be achieved by amending the 1961 Land Compensation Act to remove "prospective planning permission" from the compensation arrangements. This would have a direct impact on land prices causing market values to fall much closer to use value as they do in countries like Germany and The Netherlands.

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This market-based solution would improve the efficiency of the land market and reduce the need for costly and wasteful government intervention, such as spending nearly 10 times more on housing benefit than Germany as a percent of GDP[4]. It would also help solve the three issues listed above:

- Private sector housebuilders would be able to expand capacity given that they would no longer have to manage the risk of the value of land through time. They could instead focus their business model on building out units based on a more traditional price quality payoff, which is how most other markets function.
- Small housebuilders would no longer be at a disadvantage, and individuals who chose to self-build would also be able to compete on a fair basis, assuming that local plans allocated plots for this kind of housing output.
- It would also facilitate large scale investment across the country which can be funded by the rise in land values. This is precisely how many regions across continental Europe invest in local infrastructure as they are able to borrow from the capital market using revenue streams derived from the uplift in land values to pay back the bond holders.[5]

Consequences: how many homes could land reform deliver?

By enabling local authorities to capture the uplift in land values instead of the landowner, there would be a dramatic change in the level of infrastructure investment across England. Prior analysis estimated that this could increase investment by as much as £9.3 billion per year. [6]

Data collected and analysed by the Centre during its analysis of the Oxford to Cambridge corridor suggests that the level of housebuilding can be raised by 8,200 per annum based on annual investments of £680 million excluding land costs.[7] A more useful estimate on how much incremental infrastructure investment might increase housebuilding would be to base it on current housebuilding splits between greenfield and brownfield. This suggests that increasing investment by £790m could lead to additional output of 8,200 per annum. [8]

£9.3bn

Estimated increase in investment per year if uplift in land values would be received by local communities.

To what extent utilising these kinds of infrastructure costs for developments in London or across the Core Cities is clearly open to question. London generates significantly higher jumps in land values which the Centre estimates to be just under £4.7bn per annum. This uplift could easily self-fund Crossrail II and add more than 200,000 residential units. The land value uplift for Manchester would instead be expected to rise by around £250m per year.[9]

3 As discussed in Aubrey, T. (2016) Bridging the Infrastructure Gap, http://progressive-policy.net/2016/06/bridging-the-infrastructure-gap/
4 Where the public authority is both the landowner and investor this is possible as shown by the North West Cambridge development where the bond prospectus requires the sale of 1500 units with planning permission
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6 Centre for Progressive Policy (2017) Estimating land value capture for England – updated analysis. Available at http://progressive-policy.net/2017/03/estimating-land-value-capture-england-updated-analysis/
7 Aubrey, T. (2017), Funding the infrastructure and affordable housing for the East West corridor. Available at: http://progressive-policy.net/wp-content/uploads/2017/10/Financing_East_West_Online.pdf (This analysis was based on a ratio of 80:20 greenfield to brownfield. As brownfield ratio increases then the number of units falls per £ invested)
8 In Bridging the Infrastructure Gap, Aubrey, T. (2016) it was estimated that using a 52:48 brownfield to greenfield ratio is probably more appropriate.
9 Aubrey, T. (2017) New land compensation rules will drive up infrastructure investment and raise the rate of housebuilding. Available at: http://progressive-

Despite these significant differences, the data does provide a useful anchoring point for these kinds of analyses. For example, analysis by the Centre has identified that average rising land values across the Birmingham and Leeds City Regions generate similar levels of land value capture to the Oxford to Cambridge corridor of £478m per annum.

Table 2: Potential land value uplift and new housebuilding by Core Cities

City Region	Annualised uplift in £m	Incremental units built per annum
Birmingham	551	5,798
Leeds	369	3,879
Newcastle	301	3,169
Bristol	288	3,027
Manchester	247	2,601
Sheffield	228	2,402
Nottingham (D2N2)	193	2,032
Liverpool	109	1,151
Total	2,286	24,058

Source: DCLG, National Infrastructure Commission, Centre for Progressive Capitalism[10]

Assuming that the estimates derived from the Oxford to Cambridge corridor are a reasonable average for England, then the additional £9.3bn unlocked through land reform could pay for the necessary infrastructure for an additional 96,500 units per annum, a quarter of which would be in the Core Cities.

If these assumptions are reasonable, then this would come very close to meeting the government's new target of 300,000 units per year. Moreover, 36% of these units would be affordable and fully paid for through this mechanism, which amounts to an additional 35,000 units per year.

Going back to go forward

Without reform of the land market to remove incentives to hoard and speculate in land, it is hard to see how the different sectors might be able to expand capacity significantly. Furthermore, reform of the land market is central to enabling smaller housebuilders and self-build projects to grow market share, thereby increasing capacity across the sector. Finally, without reform of the land market, it is hard to see how the large-scale investment that is so desperately needed to raise the rate of housebuilding will be funded.

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But far from being a leap into the unknown, these reforms would actually be a return to how Britain used to build houses. The popular garden cities, new towns and infrastructure projects built in the first half of the 20th century were possible because they used the uplift in land values to fund the projects.

policy.net/2017/05/new-land-compensation-rules-will-drive-infrastructure-investment-raise-rate-housebuilding/ Analysis for Core Cities based on NIC assumptions suggests that large scale infrastructure will boost unit production by at last 35% and hence increase land value capture rates.

10 For definition of city regions by local authority, see Aubrey, T. (2017) New land compensation rules will drive up infrastructure investment and raise the rate of housebuilding. Available at: http://progressive-policy.net/2017/05/new-land-compensation-rules-will-drive-infrastructure-investment-raise-rate-housebuilding/